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SUBJECT: SRI LANKA: OIL EXPLORATION PROSPECTS REAL, BUT CONSTRAINED
BY UNREALISTIC GOVERNMENT EXPECTATIONS

REF: A) 2006 COLOMBO 431 B) 2006 COLOMBO 1902
C) COLOMBO 200 D) COLOMBO 418

¶1. (SBU) Summary: U.S. experts who have looked at recent geological survey data believe that significant petrochemical deposits lie off the coast of Sri Lanka. On May 1, the Ambassador will join Sri Lanka's Petroleum minister and others at the Offshore Technology Conference in Houston to describe this potential investment opportunity for U.S. oil companies. At that conference, Sri Lanka will announce plans to solicit international bids on three of its eight offshore exploration blocks between May and October this year.

¶2. (SBU) Summary cont'd: The U.S. Trade and Development Agency is assisting Sri Lanka's inexperienced Petroleum and Resources Development Secretariat in preparing a regulatory structure to govern the oil exploration process. However, Sri Lanka turned down the USG's offer to help it develop a marketing plan and a model production sharing contract for the upcoming licensing round. It did so in haste to get on with the licensing round -- a sign that political expediency is likely to outweigh good judgment in this critical national development opportunity. Similarly, Sri Lanka's early decision to reserve an exploration block each for China and India is troubling both as a reflection of how much sway those big neighbors hold with Sri Lanka and as an indication of how Sri Lanka continues to manage major national economic policies in a non-transparent and non-market fashion. End summary.

EIGHT BLOCKS: THREE TO BE AUCTIONED NOW,
THREE LATER, TWO RESERVED FOR CHINA AND INDIA

¶3. (SBU) According to USG and other experts, seismic surveys indicate the potential for significant oil and gas deposits in the Mannar Basin off Sri Lanka's northern and western coasts. Sri Lanka's Ministry of Petroleum and Petroleum Resources Development has identified eight blocks for exploitation. According to the Petroleum and Resources Development Secretariat, Sri Lanka will promote and auction three of those blocks with a May-October 2007 licensing round; it plans to award exploration licenses in early 2008; exploration could begin in 2009; production could be possible by 2012. Sri Lanka has reserved two other blocks for China and India. It will keep the final three blocks aside for a future bidding round. The eight blocks comprise both shallow and deeper

waters; the easiest to explore blocks will be auctioned first. According to one U.S. expert, the Mannar Basin could contain among the best oil and gas reserves in South Asia. High world oil prices, if sustained, make it more likely that Sri Lanka's reserves will be viable to develop.

¶4. (SBU) Petroleum Minister A.H.M. Fowzie will announce the opening of the initial bidding round at the April 30-May 3 Offshore Technology Conference in Houston. The conference will feature a May 1 industry breakfast focused on Sri Lanka, organized by the U.S. Department of Commerce. Ambassador Blake will participate, to describe U.S.-Sri Lanka relations and the investment climate in Sri Lanka. Petroleum and Resources Development Secretariat Director General Neil De Silva will give a technical overview of the offshore oil potential in the Mannar Basin. The managing director of Chevron's Caltex Sri Lanka operation will describe the private sector perspective on investing in Sri Lanka.

PROMISE OF TWO BLOCKS TO INDIA AND CHINA WITHOUT CLEAR TERMS -----

¶5. (SBU) Sri Lanka decided long before readying the upcoming licensing round to allot an exploration block each to India (in 2003) and to China (in 2006). The GSL has told emboffs that it reserved the blocks for India and China because it views the two countries as "strategic partners." Some GSL officials have told us that they likewise regard the United States as a strategic partner and that it should get a block too. In response, we have emphasized that we believe a competitive and transparent process would be best for Sri Lanka and for the private companies that would bid on the blocks, and that we are confident that U.S. companies could deliver the best expertise and value.

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¶6. (SBU) The GSL has not disclosed which blocks will go to India and China, but has begun discussing possible terms for the eventual award of blocks to Chinese and Indian firms. On February 7, Minister Fowzie told the press that Sri Lanka hoped to receive \$100 million each from China and India for the blocks. He recently told Econoff that China had not yet replied to this proposal and that discussions were underway with India. Post, on the advice of USTDA's consultant, has recommended that Sri Lanka attempt to use as a basis for these deals the same production sharing agreement that would govern the competitively auctioned blocks. This would avoid the distortive impact of having companies potentially bringing oil up from different blocks under different financial terms.

FINAL THREE BLOCKS HELD IN RESERVE -----

¶7. (SBU) The final three blocks identified for future development will be held in reserve, pending the outcome of the initial licensing round. Director General De Silva believes the GSL will learn from the initial licensing round, and will be able apply those lessons in a later bidding round. Further, he notes that technological advances might improve the viability of exploring the more difficult fields. (Comment: This is one of Sri Lanka's most prudent decisions involving offshore development so far.)

MARKETING AND BIDDING ROUND PLANS -----

¶8. (SBU) The GSL will announce which blocks will be available in the initial licensing round on May 1 at the Offshore Technology Conference. The Secretariat is currently evaluating several proposals by consultants to assist in preparing for and marketing the bidding round. These services will consist of preparing the production sharing contract, conducting a road show, and writing software to evaluate exploration bids. Dr. De Silva anticipates the road show taking place in July and August in the United States, London, Dubai and Singapore, leading to the blocks being auctioned off by October, or no later than early 2008.

UNREALISTIC EXPECTATIONS FOR GSL-CONTRACTED CONSULTANT

¶9. (SBU) In 2006, USTDA offered to fund a consultant to develop a production sharing contract and develop and implement marketing plans. It funded a definitional mission for this work. The Petroleum Resources and Development Secretariat used many of the suggestions provided at that time to develop its plans. The proposed USTDA grant would have improved the likelihood that Sri Lanka received high quality, comprehensive services, and increased the potential for a transparent bidding process for the fields. But the Secretariat declined this offer, citing the need to minimize preparatory time for these consultancy services (Ref B). The Secretariat on February 15 published a small ad in a local paper to

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request proposals for these services, which Embassy reported (Ref D). That RFP allowed only five weeks for submission of proposals, which limited both the time for word to spread about the RFP and the time companies would have to prepare bids. One U.S. company official told Econoff that the fees the GSL expected to pay were insufficient to provide the entire set of services requested.

USTDA CONSULTANT TO DRAFT PROPOSED
REGULATORY SYSTEM FRAMEWORK

¶10. (U) The GSL gladly accepted a related USTDA offer to grant \$474,000 to develop a regulatory structure to govern the oil development process, including designing of a regulatory authority (Ref C). This assistance will facilitate development of a productive Secretariat while outlining world-class legal, operational, environmental, and safety standards offshore. Ambassador Blake and Secretary of the Treasury Jayasundera signed the grant agreement on March 14. Several dailies reported the signing on their front page, or on the first page of their business section. In keeping with USTDA requirements, this technical assistance project will be carried out by a U.S. company. USTDA's request for bids opened on March 30 and will close on May 15.

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U.S. MINERALS MANAGEMENT SERVICE CONDUCTS
RESOURCES MANAGEMENT SEMINAR

¶11. (SBU) Additional U.S. assistance was provided by the Minerals Management Service, which held a three-day training course on "managing oil and gas resources" in Colombo in December 2006. Facilitated by USAID, the workshop covered oil and gas management systems, leasing and tendering methodologies, risk management, resource evaluation and inspection. The session concluded with a simulated lease sale. Petroleum and Resources Development Secretariat staff, as well as a core group of officials from various

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line agencies who are expected to work together on oil exploration related work, attended the course. The workshop provided critical first-time exposure to offshore development issues for most of the attendees, who lacked any prior knowledge or experience in resource management.

¶12. (SBU) Bio note: Dr. De Silva is the only real oil development expert within the Ministry of Petroleum Resources Development. He is a Canadian Sri Lankan dual citizen with M.Sc. and Ph.D. degrees, a diploma in business administration. For over two decades, Dr. De Silva has served as a petroleum geologist, petroleum geophysicist and exploration manager, mainly in Newfoundland. He is a consultant to the Integrated Ocean Drilling Program at Texas A&M University. He returned to Sri Lanka at the government's request to lend expertise to this critical national opportunity.)

COMMENT: FUMBLING A MAJOR OPPORTUNITY

¶13. (SBU) Despite our attempts to assist, and Dr. De Silva's professionalism, we fear that Sri Lanka is fumbling this critical

opportunity to develop a valuable national resource. While Minister Fowzie no longer blithely tells the press that oil derricks will gush oil within eight months (as he did frequently last year), Sri Lanka still appears unwilling to spend the time and resources to get the offshore oil development process right the first time. If so, it will never get as good a chance to convince the international oil companies that it can be a professional partner in a long-term and mutually profitable process. Still, Post continues to press for appropriate planning, development and marketing of these fields, to ensure that the bidding cycle as is competitive and transparent as possible.

BLAKE